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No. 1250

IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

GENERAL FOODS CORPORATION, *Petitioner*

v.

FEDERAL TRADE COMMISSION, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Petitioner prays that a writ of certiorari issue to review a final judgment of the United States Court of Appeals for the Third Circuit entered in this case on December 21, 1967.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 386 F.2d 936 (1967) and appears at Appendix A to this petition. The final order and opinion of the Federal Trade Commission (Dkt. 8600) is reported at — F.T.C. —, [1965-67 Transfer Binder] TRADE REG. REP.

¶ 17,465 (FTC 1966), appears at Appendix B to this Petition.

JURISDICTION

The judgment of the Court of Appeals was entered on December 21, 1967, and appears at Appendix A to this Petition. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1964) and Section 11(c) of the Clayton Act, as amended, 15 U.S.C. § 21(c) (1964).

QUESTIONS PRESENTED

1. Where a relevant "product submarket" has been selected in a conglomerate merger case, may the economic effect upon that submarket of close substitute products being developed and marketed by numerous aggressive and well-financed rivals be treated as legally irrelevant in determining whether the merger may substantially lessen competition within the submarket?

2. Where the record in a conglomerate merger case shows the existence of numerous identified potential competitors of great size and strength in close economic proximity to the relevant submarket, may a reviewing court of appeals properly conclude that the merger is illegal on the basis of an abstract conclusion (different from that of the Federal Trade Commission below) that the merger raised entry barriers, without any determination whether, in light of the character of the potential competitors, their competitive influence upon the relevant submarket was lessened or whether they might actually be deterred from entry?

3. Is an increase in efficiency in the operations of an acquired firm as a result of a conglomerate merger an affirmative reason for invalidating the merger under the antitrust laws?

STATUTE INVOLVED

Section 7 of the Clayton Act, 64 Stat. 1125 (1950), 15 U.S.C. § 18 (1964), amending 38 Stat. 731 (1914), provides in pertinent part as follows:

> "No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

STATEMENT

In this conglomerate merger case the acquired company was the S.O.S. Company, a closely-held corporation which since 1919 had been engaged in the manufacture of scouring devices for the housewife's use in the kitchen. (R. 979a.[1]) Its principal product was the "S.O.S." soap pad, a soap-impregnated steel wool pad used primarily for cleaning pots and pans. (R. 521-22a, 1480a.)

In the 1950's the principal S.O.S. shareholder "was getting along in years" and wanted to sell the business and retire. (R. 411a.) He approached petitioner, General Foods Corporation ("GF"), with a view to a sale of the S.O.S. business. (R. 1010a.) GF, a large

[1] The Record in this Court includes the printed joint appendix in the Court of Appeals. "R." citations are to pages of this joint appendix. GF exhibits are designated "RX" and FTC exhibits "CX." For convenience, the pagination of the Commission opinion as it appears in the printed Record has been retained in Appendix B to this Petition.

manufacturer of packaged food products, had never manufactured or sold products in any way comparable or related to those of S.O.S. (R. 52a, 1401a), and was not an actual or potential competitor or an actual or potential supplier or customer of S.O.S. (App. A, p. 20; App. B, p. 234a; R. 6a, 15a, 163a, 367a, 410a, 411a). On December 31, 1957, GF purchased all of the assets of the S.O.S. Company. (R. 3a, 14a.) Some six years later the Federal Trade Commission issued a complaint alleging that the acquisition violated Section 7 of the Clayton Act, 15 U.S.C. § 18. (R. 1a.)

On March 17, 1966, by a vote of three to two, the Commission held that this conglomerate merger violated Section 7 and ordered divestiture. (App. B, pp. 189a-90a.) The Commission's majority opinion, written by Commissioner Mary Jones, concluded that the merger was "identical in all respects" (App. B, p. 212a) to that found unlawful in *Federal Trade Commission* v. *Procter & Gamble Co.*, 63 F.T.C. —, [1963-65 Transfer Binder] TRADE REG. REP. ¶ 16,673 (FTC 1963), *rev'd*, 358 F.2d 74 (6th Cir. 1966), *rev'd*, 386 U.S. 568 (1967) (hereinafter the "*Clorox*" case).

The dissenting opinion was written by Commissioner Elman, the author of the Commission's opinion in *Clorox*. He concluded that the present case was markedly different from *Clorox* in several respects:

(1) In *Clorox* the acquiring company was virtually the only potential competitor of the acquired company, so that the merger had the effect of eliminating virtually all potential competition. In this respect, Commissioner Elman pointed out, the acquisition in *Clorox* "had many of the same effects on competition as a conventional horizontal merger." (App. B, p. 252a.)

But in this case, because GF was not a potential competitor of S.O.S.,[2] the acquisition had no such horizontal aspects.

(2) *Clorox* involved a unique product for which there were no substitutes, and, by definition, the possible exercise of oligopoly power within the market was not subject to any restraint from substitutional competition. But in this case, as Commissioner Elman emphasized, there existed outside of the relevant market a number of giant companies with "vast resources and marketing power" who were developing and selling a variety of close substitute products and were thus exerting a powerful restraining influence upon the exercise of oligopoly power within the relevant submarket. In short, in *Clorox* the acquisition eliminated virtually all external restraining influence, but in this case strong and growing restraining influences continued in force after the acquisition. (App. B, pp. 255-59a.)

(3) One of the evils found in *Clorox* was the achievement by the acquired company of certain advertising cost-savings which, because additional brand advertising in that particular market was not considered socially useful, were thought to create an anticompetitive advantage. But in this case the acquired company was able to achieve certain genuine and desirable efficiencies in transportation and warehousing, as well as in advertising and promotions, and Commissioner Elman did not believe that the genuine efficiencies involved here stood on the same ground as the advertising cost savings involved in *Clorox*. (App. B, pp. 261-62a.)

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[2] The tribunals below explicitly so found. (App. A, p. 20; App. B, p. 234a, 254a; R. 163a [Finding of the Hearing Examiner].)

For the foregoing reasons Commissioner Elman concluded that this case, far from being "simply an echo of *Clorox*" (App. B, p. 249a), broke new ground on issues which were of great importance to the administration of the Clayton Act and that upon a correct legal and economic analysis the acquisition did not violate the statute.

GF petitioned the Court of Appeals for the Third Circuit for review.[3] The Court of Appeals agreed with Commissioner Elman that the case was economically different from *Clorox* (App. A, pp. 19-21), but it nevertheless affirmed the decision of the Commission's three-member majority. Because the case involves important antitrust issues, petitioner seeks certiorari.

I. The Issue of Substitute Products

A. The Facts

Steel wool was one of the first abrasive substances to be used in kitchen scouring devices. (R. 313a, 615-16a.) Over the years various methods of incorporating soap into a steel wool pad were developed in order to supplement the abrasive action of the steel, and the "soap pad" made of steel wool has long been the leading kitchen scouring device. (R. 982a, 1480a, 1490a, 1527a.)

From 1919 to 1946 there were apparently only three manufacturers of steel wool soap pads—the S.O.S. Company, the Brillo Company, and the American Steel Wool Company. (R. 561a.) Between 1946 and 1957 two new manufacturers entered the field, the Durawool Corporation (R. 565a) and the Alloy Corporation (R. 86a-87a, 597a). Each of the five companies manu-

[3] Jurisdiction of the Court of Appeals was founded upon Section 11 of the Clayton Act, 15 U.S.C. § 21 (1964).

factured different types of steel wool devices,[4] and an additional type was introduced into the Canadian market by the Colgate-Palmolive Company. (R. 631a, 1740a-41a.) Following GF's acquisition of S.O.S. the Alloy Corporation dropped out of the business (for reasons wholly unrelated to GF's entry) (R. 86a-87a, 597a, 641a); a company called Demcorp entered for the first time (R. 640a); the B. T. Babbitt Company (Bab-O) made a brief entry (R. 1523a); Colgate-Palmolive introduced its steel wool soap pad into the American market;[5] and both Lever Bros. and Procter

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[4] The "SOS" pad, which was patented in 1918 (R. 982a), is made of interwoven steel fibers in an oval shape, impregnated with a blue soap. (RX 1, R. 1480a.) The Brillo products are "Brillo Green," a plain steel wool pad boxed with a separate cake of soap (RX 2, R. 1490a) and "Brillo Red," a pillow-shaped pad of noninterwoven steel fibers covered with a red soap (RX 1, R. 982a, 1480a). "Brillo Red" once contained, and may still contain, detergent as well as soap. (R. 1749a-50a.) The American soap pad is a roll of fine steel wool with soap spread in the interior. (RX 2, R. 1490a.) The American scour pad is a similar roll for use with a separate cake of soap. (R. 141a.) The Durawool soap pad is round, impregnated with a red soap. (RX 2, R. 1490a.) Demcorp's new "Puffy" pad is a ball of steel wool with a lemon-scented, oil-based soap in a "magic nugget" in the interior. (R. 1527a.) "Paddy," a recent innovation of Brillo, is a small flat steel wool pad with a hard paper back. (RX 5, 1515a.) "S.O.ettes," which were introduced after "Paddy," are small, flat disposable steel wool pads with soft sponge backs. (RX 5, R. 1515a.)

[5] At the close of the hearing below, Colgate-Palmolive was selling its pad in Canada but had not yet introduced the pad in the United States. Following the decision of the Court of Appeals below, GF petitioned the Court of Appeals for leave to adduce new evidence before the Commission to show a number of highly relevant new developments in the market (as established by a supporting affidavit whose factual assertions were in effect conceded), including the fact that in 1966 Colgate-Palmolive had introduced its steel wool soap pad into the United States. The motion (which was denied) and the supporting affidavit are included in the Record and appear at Appendix C to this Petition.

& Gamble have been working on the development of new steel wool pads (R. 580a-81a).

Although steel wool is an effective abrasive, it also has incurable inherent defects, including its rusting and splintering, its harshness on the hands, and its relatively short useful life. (R. 448a, 457a, 520-21a, 523a, 533a, 554a, 590a, 1571a.) Indeed, manufacturers of steel wool soap pads are so well aware of these deficiencies that none uses the words "steel wool" on the package for his product. (R. 590a, 1145a-46a, 1365a-68a, 1457a, 1467a; *see* R. 316a.) Perceiving an opportunity to capitalize on these deficiencies, a number of other manufacturers in recent years have developed new kinds of non-steel kitchen scouring devices employing such abrasive substances as silica, bronze and copper webbing, nylon webbings with bonded abrasives, and various combinations of these and other materials. (R. 68a-70a.) Some of these pads incorporate soap and some do not. All of them are advertised and sold from grocery store shelves—usually side by side with the traditional steel wool pad—to the housewife for use in her kitchen scouring chores. (R. 318a, 477a-78a, 524a, 626a, 659a, 784a, 785-86a, 795a, 893a, 1560a-75a.) Many of these modern non-steel products, several of which have been developed since GF's acquisition of S.O.S., are expressly advertised as being superior to steel wool (R. 120a-21a, 1952a, 1954a), and their manufacturers have deliberately priced their products so as to be competitive with the prices of the traditional steel wool pads, taking into account the useful lives of the products.[6] (R. 171a.)

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[6] A leading example is the so-called "Rescue" soap pad manufactured by Minnesota Mining & Manufacturing Company. It is a long-life pad made of nylon webbing with a highly effective abrasive bonded to the webbing (under a patent obtained in 1960),

The manufacturers of these modern non-steel substitutes include the du Pont Company (R. 1509a-10a), General Mills Corporation (R. 1490a), General Cable Corporation (R. 1480a, 1499a, 1690a), Colgate-Palmolive Company (R. 531a-32a, 580a, 914a), and Minnesota Mining & Manufacturing Company (R. 895a, 1469a-79a), and additional major companies such as the Procter & Gamble Company, Lever Bros., American Home Products, and Union Carbide Corporation have been developing similar substitute products (R. 532a, 580a, 618a, 887a). The new substitute products already on the market have been steadily drawing business away from the traditional pad manufacturers as housewives have switched from the old products to the new. (R. 157a, 516-18a, 534a, 786a-87a, 817a, 1565a.) The record establishes that, since the close of the hearing below, the growth of steel wool soap pads has been stopped entirely and that in 1966, for the first time in history, sales of such pads started into an apparently steady decline.[7]

B. The Opinions Below

The Commission below took the position that, in the context of a broad market encompassing many competitive products, the Commission and the courts have

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and it contains soap. (R. 891a.) The manufacturer testified that he deliberafely set his box price at exactly the price of a box of steel wool soap pads having a comparable useful life. (R. 171a, 893a, 895a, 916a.) "Rescue" is explicitly advertised as being superior to steel wool soap pads (R. 120a-21a), and it appears on the shelves of grocery stores between the Brillo pad and the S.O.S. pad (R. 787a, 892a). Although sold only in test markets at the time of the Hearing in 1964, the Record shows that "Rescue" is now in national distribution. (*Supra* n. 5; App. C, p. 4.)

[7] Sales are now falling at the rate of 4-7% per year. *See* GF's motion in the Court of Appeals, *supra* n. 5; App. C, p. 4.

broad discretion to identify as a "relevant submarket" for the purposes of Section 7 any one of a number of products groupings within the outer boundaries of the market as a whole. (App. B, p. 198a.) Noting a number of Section 7 cases in which products which are "in direct competition" with one another had been separated into distinct submarkets (App. B, pp. 194-95a), the Commission chose as the "relevant submarket" in this case a product category which it characterized as "household steel wool"—*i.e.*, scouring devices made of steel wool, whether or not soap impregnated. (App. B, p. 206.)

GF urged below that, assuming the propriety of the selection, it was incumbent on the Commission under the teaching of *Clorox* to evaluate the role of all competitive influences—including the potential competition of close substitute products—which might serve as a restraint upon the exercise of oligopoly power within the "relevant submarket." The three-member majority of the Commission rejected GF's contention. They flatly held that the competitive influence of the substitute products outside the steel wool submarket was legally irrelevant and entitled to no consideration in the evaluation of the consequences of the acquisition:

> "Respondent argues that 'whatever the technical definition of the product market no rational evaluation of present or future competitive conditions can be made without taking non-steel scouring devices into account.' . . . It is clear, however, under Section 7 of the Clayton Act, that once the appropriate product market for determining the effect of the merger has been defined, the only consideration which is relevant is whether or not there is a reasonable probability that competition in that market may be substantially lessened. . . . *Conse-*

quently, we reject respondent's contention that, whatever the definition of the market may be, we must nevertheless still consider the broader cleaning device market in our assessment of the competitive impact of respondent's merger." (Emphasis added.) (App. B, p. 198a, n. 5.)

Commissioner Elman sharply disagreed. In dissent he pointed out that no realistic appraisal of the structure of the household steel wool submarket, or of the likely future behavior of firms within or contemplating entry into that submarket, could be made without taking into account the emerging competition of substitute non-steel scouring devices. (App. B, pp. 255-60.) He concluded that, given the existence of numerous giant and aggressive manufacturers of new substitute products (as well as other factors), the replacement of the S.O.S. Company by GF in the steel wool submarket had not increased any opportunity for the exercise of oligopoly power within that submarket and had not substantially lessened competition in violation of Section 7. (App. B, pp. 260a-61a.)

Despite the sharp division among the members of the Commission on this important issue, the opinion of the Court of Appeals is silent on the point. The court duly noted GF's argument as to the role of the substitute products and their legal significance [8] but never discussed it at all.

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[8] "Appellant further argues that even if the market definition was technically tenable, the Commission nevertheless erred in assessing the impact of the merger by treating non-steel wood scouring devices as though they did not exist." (App. A, p. 7.)

II. The Issue of Entry Barriers

A. The Facts

As noted above, the record shows that beginning some time before the acquisition and continuing throughout the post-acquisition period there have been a number of potential entrants into the steel wool soap pad business, including the Procter & Gamble Company, the du Pont Company, General Mills Corporation, General Cable Corporation, Minnesota Mining & Manufacturing Company, Lever Bros., American Home Products Company, and Union Carbide Corporation. (R. 531a-32a, 580a, 618a, 887a, 895a, 914a, 1469a-79a, 1480a, 1490a, 1499a, 1509a-10a, 1690a.)

Apart from these potential entrants, following GF's entry into the steel wool business by acquisition, three additional companies have actually entered the market with new steel wool soap pads. They are Demcorp (R. 640a), the B. T. Babbitt Company (Bab-O) (R. 1523a), and Colgate-Palmolive.[9]

B. The Opinions Below

As further discussed below, the three-member majority of the Commission concluded that the S.O.S. business, because of GF's ownership, was in a position to take advantage of certain operating efficiencies which were not available to the S.O.S. Company prior to the acquisition. (App. B, pp. 234a-38a.) The majority also inferred, admittedly without evidence and

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[9] The Commission found that Demcorp was a new entry. (App. B, p. 242a.) It apparently overlooked the evidence as to Bab-O. Since Colgate-Palmolive did not enter the market until after the Commission's decision, the Commission treated that firm as only a "potential competitor" (App. B, p. 219a), but it has now become an actual competitor (*supra* n. 5; App. C, pp. 4-5).

without reference to the character of the identified potential competitors, that GF's presence in the steel wool soap pad business had necessarily created a "psychological" barrier tending to deter potential competitors from actually entering the Market. (App. B, p. 241a.) On this basis the Commission concluded that GF's 1957 entry had raised barriers in the steel wool market to "virtually insurmountable heights." (App. B, p. 219a.) This conclusion was reached in the face of some actual new entry into the market following GF's entry, and without considering whether any of the identified potential competitors would actually be deterred by GF's presence in the steel wool business.

Again Commissioner Elman disagreed with the majority. He took the view that, where in fact there are a number of identified major companies standing at the edge of the market in the role of potential competitors, a determination as to whether a merger has raised entry barriers sufficiently to violate the statute requires an evaluation of the character and resources of the identified potential competitors to determine whether they would in fact be deterred by the merger from entering the market. Accordingly, Commissioner Elman examined the identity of the potential competitors and concluded that there had been no raising of entry barriers so as to remove those companies as a restraining influence within the steel wool submarket:

> "On no realistic appraisal of the market would it appear that du Pont, Colgate, and these other giants are likely to be discouraged from taking on S.O.S. as a competitor because it has been acquired by General Foods. *In relation to these firms, the substitution of General Foods for S.O.S. has surely raised no barriers to entry or eliminated the potential competition that now exists.*" (App. B, p. 259a.) (Emphasis added.)

On appeal GF, pointing to the identity of the leading potential competitors, vigorously challenged the majority's finding that the acquisition had raised entry barriers to "virtually insurmountable heights." (*See Brief for Petitioner in the Court of Appeals,* pp. 22-23, 33-35.) Faced with this challenge and a divergence of view in the Commission, the Court of Appeals took a middle ground. It did not endorse the majority's "virtually insurmountable heights" conclusion, but it did hold that there was substantial evidence that entry barriers had been raised to *some* extent. (App. A, pp. 18-19, 21.) The court did not consider, as Commissioner Elman did, whether the increase in entry barriers was sufficient to reduce the competitive influence of the large identified potential competitors who were actually standing at the edge of the market, or whether the increase was sufficient to deter actual entry by any of these specific firms.

III. The Issue of Operating Efficiencies

A. The Facts

As a ground for invalidating the merger, counsel supporting the Complaint repeatedly urged upon the Commission and the court below that the S.O.S. business, as a result of its acquisition by GF, did or could achieve cost savings in transportation and warehousing as well as in advertising and promotion. Particularly stressed, for example, were the "important advantages" accruing to S.O.S. and its customers from GF's "stream-lined" and "market-centered distribution system," including "warehousing by the most efficient time and labor-saving devices," "distribution by the most advantageous rate of transportation," coordination of invoicing, credit arrangements, and other phases of purchase order processing, and other "obvious econ-

omies of scale." (*See, e.g., Brief for the Commission in the Court of Appeals,* pp. 12-13, 20-21, 45, 48, 55-57, citing R. 1097a-98a, 1392a.) Taking advantage of these "handling and transportation economies," Commission counsel said, a retailer could obtain S.O.S. pads at a lower unit price (*id.* at pp. 13, 21, citing R. 1059a, 1304a) and was "enabled to run his business more economically by holding his investment in inventory to a minimum" (*id.* at pp. 13, 21, citing R. 375a-77a, 1053a-54a). The Commission and the Court of Appeals accepted these propositions as fact and found that all these cost savings resulted from the merger. (App. A, pp. 6, 18-19; App. B, pp. 210a-11a, 217a, 222a, 237a, 238a.)

B. The Opinions Below

The majority of the Commission relied expressly upon the alleged operating efficiencies which were or could be achieved by the S.O.S. business as a result of the acquisition as a basis for holding the acquisition unlawful under Section 7. (App. B, pp. 210a-11a, 217a, 222a.) Commissioner Elman dissented. He said:

> "The Commission also includes, as a ground for holding this merger unlawful, purported cost savings accruing to S.O.S. through efficiencies in warehousing and distribution. . . . Economic efficiencies should not be a ground for the invalidation of a merger. Indeed, the promotion of competition has for one of its goals the achievement of greater efficiency. *See* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1323-28." (App. B, p. 261a).

The Court of Appeals disagreed with Commissioner Elman and sustained the Commission majority. (App. A, pp. 6, 18-19.)

REASONS FOR GRANTING THE WRIT

None of the three questions raised in this case was raised by the facts in *Clorox,* but each is a question which is likely to arise in many conglomerate situations in the future. Thus *Clorox* did not involve the economic and legal significance of substitutional competition as a factor existing outside of, but exerting a competitive influence within, the relevant product market. But most products are subject to some degree of substitutional competition, and the question of the significance of such competition may often be crucial in conglomerate cases.[10] Similarly, although in *Clorox* there were no identified potential competitors other than the acquiring company, it is to be expected that in many conglomerate cases, as here, there will be other identifiable potential competitors exerting an influence upon the market after the acquisition, and in such cases the question of the significance of the character of those competitors will arise. Finally, while in *Clorox* no increases in genuine economic efficiency were involved, genuine increases in efficiency of the kind involved in this case will in all probability be encountered in many conglomerate cases.[11] In these respects the resolution of the questions presented in this case—the first true conglomerate case to reach this Court[12]—is likely to have a broad impact in the merger field in the future.

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[10] *Cf.* BOCK, MERGERS AND MARKETS 159 (6th ed. 1968).

[11] *See* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1315 (1965); Hale & Hale, *More on Mergers,* 5 J. LAW & ECON. 119, 125 (1962); PENROSE, THE THEORY OF THE GROWTH OF THE FIRM 129-30 (1959).

[12] As emphasized by Commissioner Elman below, the Clorox acquisition was analogous to a horizontal merger because Procter was a potential competitor of Clorox. *See* p. 4, *supra.* Here there was no such prior economic relationship between the acquiring and the acquired companies.

The importance of framing intelligent rules with respect to conglomerate mergers (which have become the principal vehicle for the sale of capital assets in the United States economy today [13]) cannot be overemphasized. Unduly severe interdiction of conglomerate mergers can and will stifle the opportunities and incentives of potential new innovative enterprises which are considering formation and entry into particular markets. Undiscriminating merger rules may thus actually raise entry barriers so as to protect and preserve existing oligopoly power [14] and, in addition, lead to an increase in general concentration.[15] It is therefore important for this Court in this case to insure that the rules which are to govern conglomerate mergers for the immediate future are designed to enhance rather than to inhibit competition.

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[13] *See Hearings Before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, pursuant to S. Res. 40,* 89th Cong., 1st Sess., pt. 2, at 516 (1965).

[14] *See, e.g.,* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1317-18 (1965) ("There are thus strong reasons for not making the prohibitions of section 7 so extensive as to damage seriously the market for capital assets, or so broad as to interfere materially with mergers that are procompetitive in their facilitation of entry and expansion that would otherwise be subject to serious handicaps." p. 1318.); KAYSEN & TURNER, ANTITRUST POLICY 127-29 (1959).

[15] *See* BAIN, INDUSTRIAL ORGANIZATION 204, 206-07 (1959); Turner, *supra* n. 14, 78 HARV. L. REV. at 1326-27.

I. On the Important Legal and Economic Question of the Relevance of Potential Competition From Close Substitute Products, the Rule Announced Below Conflicts With Prior Holdings of This Court and With Accepted Economic Doctrine

In prior merger cases this Court has repeatedly recognized a fundamental economic and legal principle which is applicable here. In *United States* v. *El Paso Gas Co.*, 376 U.S. 651 (1964), and in *United States* v. *Penn-Olin Co.*, 378 U.S. 158 (1964)—and of course in the *Clorox* case as well—this Court recognized that with respect to a particular market there may be external forces at work which, though they exist outside the market, may have a decisively important procompetitive influence upon the behavior of firms within the market. In each of the three cited cases the external force involved was "potential competition" in the form of one or more extra-market firms whose potential entry tended to restrain the exercise of oligopoly power within the market. In each case the Court considered it decisively important to determine whether the challenged transaction had either eliminated or reduced the influence of potential competition to such a degree that competition within the market had been substantially lessened within the meaning of Section 7.

This case involves a precisely comparable extra-market force—namely, the emerging competition of substitute products being developed and sold by numerous aggressive rivals with well-established reputations for marketing judgment and success. In addition to acting as a restraining influence upon the market behavior of steel wool pad manufacturers, they are actu-

ally drawing business away from that submarket at a rate which foreshadows the demise of the submarket itself.[16] The tribunals below have flatly held that these economic realities are legally irrelevant for Section 7 purposes. In so doing they have adopted a principle which squarely conflicts with the cited decisions of this Court.

Economically, of course, there is no difference between the restraining influence of potential entry into a given market and the influence of emerging substitutional competition. Both these forms of potential competition create, for firms within the market, the threat that their customers will leave them if they try to take advantage of imperfectly competitive conditions.[17] The threat of a shift of customers to a substitute product will act as a restraining influence upon the exercise of oligopoly power within a submarket in exactly the same way as the threat of a shift of customers to a new entrant. Indeed, if anything, substitute products constitute a more immediate and effective restraint because they are already in existence.[18] The economic equivalence of these two forms of potential competition has long been recognized by authoritative commentators from both the economic and legal disciplines. *See* COUNCIL OF ECONOMIC ADVISORS ANNUAL

[16] The affidavit in support of GF's motion in the Court of Appeals (*supra* n. 5; App. C, p. 4) establishes that sales of steel wool scouring devices are now falling at the rate of 4-7% per year. *See also* R. 157a, 534a, 1565a.

[17] As noted by Professor Bain, the availability and closeness of substitutes—*i.e.*, the degree of "product differentiation"—is as much a dimension of market structure as the "condition of entry." Entry and substitutibility are two of "the most important conditioning influences on market performance." BAIN, INDUSTRIAL ORGANIZATION 211-14, 264 (1959).

[18] *Cf.* BAIN, BARRIERS TO NEW COMPETITION 10-11 (1956).

REPORT, in PRESIDENT'S ECONOMIC REPORT 132 (1965)[19]; REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 322 (1955).[20] And in *United States* v. *Continental Can Co.*, 378 U.S. 441 (1964), this Court itself recognized the legal and economic significance of emerging substitutional "inter-industry competition" for Section 7 purposes.[21]

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[19] "In many industries, a high concentration of output among a small number of firms is not inconsistent with high active competition, especially where there is also a fringe of small firms, where entry of new firms is easy, *or where there exists active competition from substitute products.*" (Emphasis added.)

[20] The REPORT states as follows:

> "In evaluating the market forces which together would characterize effective competition, the rivalry of close substitutes which may, for other purposes, be classified as belonging in other industries has, in varying degree, the same kind of effect as that of competing producers of the same or differentiated products or services classified within the same industry. Technical advance has often made the rivalry of close substitutes quite effective."

In *United States* v. *Penn-Olin Co.*, 378 U.S. 158, 176 (1964), this Court quoted with approval the REPORT's exposition of restraints on oligopoly power, including its reference to existing rivals as well as potential entrants:

> "The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, *rival sellers, whether existing competitors or new or potential entrants into the field,* would keep this power in check by offering or threatening to offer effective inducements . . . ." (Emphasis added.)

[21] The Court pointed out that the "possibility" of "customer diversion" to a substitute product "over the long run acts as a deterrent against attempts by the dominant members of either industry to reap the possible benefits of their position by raising prices above the competitive level or engaging in other comparable practices." 378 U.S. at 465-66.

Disregarding this Court's clear effort in *Clorox* and earlier cases to make legal analysis conform to economic analysis, the tribunals below have declared that the highly significant economic fact of emerging substitutional competition is legally irrelevant for Section 7 purposes. They have held in effect that, no matter how clear the impact of such substitutional competition, the competitive consequences of a conglomerate merger are to be determined by treating such competition as though it did not exist.[22] This novel legal fiction is completely at odds with the realistic economic principles followed by this Court in *Clorox* and earlier merger cases. As indicated by Commissioner Elman in his strong dissent in this case, the rule adopted below constitutes "a long step" in the wrong direction in an

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[22] The findings upon which the Commission based its selection of the relevant product submarket—for instance, that steel wool manufacturers did not take the nascent substitutional competition into account in their pricing decisions at the time of the merger—are in no way inconsistent with the facts bearing on the future restraining influence of potential competition from substitute product manufacturers. Indeed, Commissioner Elman agreed with the majority's choice of the steel wool pad submarket. It was the size and experience of the companies engaged in the substitutional competition; the degree of their investment and their announced expectations; the vigor of the innovation and the likelihood of long-run consumer response to it—all established in the Record—which convinced Commissioner Elman that adequate and increasing restraints upon the exercise of oligopoly power in the steel wool submarket remained and that the merger had not lessened competition. These were the precise criteria for the evaluation of prospective potential competition announced by this Court in the cases cited above. *E.g.*, *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568, 580 (1967); *United States* v. *Continental Can Corp.*, 378 U.S. 441, 452, 455 (1964); *United States* v. *Penn-Olin Co.*, 378 U.S. 158, 174 (1964); *United States* v. *El Paso Gas Co.*, 376 U.S. 651, 660 (1960). As noted, the majority of the Commission and the Third Circuit viewed these economic facts as legally irrelevant and refused to consider them.

area where it is particularly important that the legal rules be evolved with caution. In view of the fact that conglomerate cases are necessarily going to turn primarily upon the question of the role of potential competition, it is of great importance that this Court resolve the question in this case.[23]

II. The Reliance of the Court Below on a Novel Abstract Rule—That Entry Barriers May Be Analyzed Without Regard to the Character of Identified Potential Entrants—Is Inconsistent With Accepted Economic Principles and With the Decisions of This Court

As previously noted, the Commission majority's finding that barriers to entry into the steel wool submarket had been raised to "virtually insurmountable heights" was challenged as untenable, both by the dissenting opinion and by GF on appeal, in view of the size and strength of the identified potential competitors.[24] The Third Circuit did not advert to this challenge. Instead it held in effect that the applicable test was *not* whether entry barriers had been raised too high (*i.e.*, to the Commission majority's "virtually insurmountable heights"), but whether they had been raised at all. The character of the potential competitors, and whether

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[23] *Cf.* Bock, Mergers & Markets 159 (6th ed. 1968). "The resolution of this issue concerning the relevance of substitute products and active rivals is, therefore, critical to the future status of mergers of the General Foods-S.O.S. type."

[24] Since the Commission majority refused to consider the influence of potential competition in the form of substitute products, its conclusion that oligopoly power had been substantially increased and competition thus substantially lessened in the steel wool submarket would be legally insufficient even if its finding as to entry barriers were valid.

an increase in entry barriers had substantially affected *their* restraining influence, went unmentioned.

The test thus applied by the Third Circuit not only departs from the theory adopted by the Commission below [25] but, more importantly, is in conflict with the basic criteria for the appraisal of potential competition announced by this Court in *United States* v. *El Paso Gas Co.*, 376 U.S. 651 (1960), *United States* v. *Penn-Olin Co.*, 378 U.S. 158 (1964), and *Clorox*, and with authoritative economic teaching on the use of entry barrier analysis in merger cases.

The opinions of this Court in *Penn-Olin*, *El Paso*, and *Clorox* make clear that tribunals must evaluate the strength and character of potential competitors in estimating their impact upon market behavior. For example, in *El Paso* the Court held that the effect of a potential competitor on competition in a market

> "is determined by the nature or extent of that market and by the nearness of the absorbed company to it, *that company's eagerness to enter that market, its resourcefulness, and so on.*" 376 U.S. at 660. (Emphasis added.)

In *Penn-Olin* the Court stated:

> "Potential competition, *insofar as the threat survives* . . . may compensate in part for the imper-

[25] It is a settled rule in this Court, as most recently reiterated by Mr. Justice Harlan concurring in *Consolidated Foods Corp.* v. *FTC*, 380 U.S. 592, 601 (1965), that a court of appeals may not sustain a decision of an administrative agency on a theory different from that articulated by the agency. *See Burlington Truck Lines Inc.* v. *United States*, 371 U.S. 156, 168-69 (1962); *accord, NLRB* v. *Metropolitan Life Ins. Co.*, 380 U.S. 438, 443-444 (1965); *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947).

> fection characteristic of actual competition in the great majority of competitive markets . . ."
>
> ". . . The existence of *an aggressive, well equipped and well financed corporation engaged in the same or related lines of commerce* waiting anxiously to enter an oligopolistic market would be a substantial incentive to competition which cannot be underestimated." 378 U.S. at 174. (Emphasis added.)

And in *Clorox* the Court noted:

> "[T]he barriers to entry *by a firm of Procter's size and with its advantages* were not significant." 368 U.S. at 581 [26] (Emphasis added.)

But the Third Circuit here made no effort to evaluate the strength of the identified potential entrants in determining whether competition within the steel wool submarket had been affected by this conglomerate merger.[27] Quite the contrary, the court looked to whether entry barriers had been raised *in the abstract,* and assumed that oligopoly power within the market had been increased "to the extent" that the barriers had been raised. (App. A, p. 21) The court failed to ask the crucial question which makes entry barrier analysis relevant to an estimation of market power—whether, in the words of *Penn-Olin,* "the threat [of

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[26] In *Clorox,* Procter was "virtually the only" potential entrant. *See* 63 F.T.C. at —, [1963-65 Transfer Binder] TRADE REG. REP. ¶ 16,673 at 21,584 (FTC 1963). Its potential competition was, of course, eliminated by the merger.

[27] There were ample facts in the Record to permit such an evaluation. R. 531a-32a, 580a-81a, 618a, 631a, 887a, 895a, 914a, 1469a-79a; RX 1; R. 1480; RX 2, R. 1490a; RX 3, R. 1499a; RX 4, R. 1509a-10a; R. 1632a, 1652a, 1664-65a; 1682-83a, 1690a, 1846a-47a, 1740a-41a, 1962a-94a, 1993-94a.

potential competition] survives" the raising of entry barriers.

Obviously an increase in entry barriers does not permit an oligopolist to take advantage of his market power unless it significantly deters potential entrants from entering. A mere comparison of the height of entry barriers after a conglomerate merger with their height before tells nothing. In simplistic terms, raising a barrier by 100%, which would certainly be a "substantial" increase, will not protect an oligopolist from potential rivals who can easily surmount the new height. Conversely, a small increase which might be regarded by the Third Circuit as "insubstantial" could free oligopoly power if it resulted in barring the important potential entrants. Economic texts explicitly recognize that the effect of entry barriers varies with the character of the potential entrants,[28] and the instructions of this Court in *Penn-Olin, El Paso,* and *Clorox* reflect this accepted understanding. The Third Circuit's mistaken view of entry barriers as a self-sufficient index of competitive conditions is thus in conflict with both law and economics.

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[28] *See, e.g.,* BAIN, BARRIERS TO NEW COMPETITION 7-10 (1956):

> "The condition of entry is measured by the long-run gap between minimal cost and price which the most favored firms can reach without attracting entry—but whose entry and how much? . . . It is not realistic to assume that all potential entrants are alike either in their capacity to enter or with respect to the gap which will just induce them to enter. . . . If the condition of entry refers to the condition for the inducement to entry of successive finite numbers of firms it should also logically refer to the *size* of each entry. . . . [T]he condition of entry to an industry . . . refers to advantages which established firms in an industry have over potential entrant firms. . . ."

And it is no small error. Applied as a general rule it could have a widespread economic impact. It could arbitrarily prohibit conglomerate mergers which do not in fact change market structure, and validate mergers which do in fact eliminate restraint on oligopoly power. Either result would be anticompetitive.

III. The Lower Tribunals' Reliance Upon Achievement of Operating Efficiencies as an Affirmative Ground for Prohibiting a Conglomerate Merger is a Radical Departure From the Accepted Goals of Antitrust Policy

In concluding that this conglomerate merger had an anticompetitive effect, the Third Circuit and the Commission majority relied principally upon evidence that GF could achieve cost savings in transporting and warehousing soap pads ("distributional efficiencies") and in advertising and promoting them. Their finding that GF could operate more economically was the crux of their decision.

Reliance upon efficiency as an affirmative ground for invalidating a merger is not a minor variation on the basic theme of antitrust policy. As Commissioner Elman pointed out in his dissent below, it represents a major departure from accepted antitrust policy, and it flatly contradicts the teaching of commentators accepted as authoritative by this Court.[29] It is a novel

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[29] *See* Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 Harv. L. Rev. 1313, 1339 (1965) ("Economies of scale in production, distribution, research, and the like should in no event be a factor militating against the lawfulness of conglomerate (or other) mergers"); Kaysen & Turner, Antitrust Policy 129 (1959); Bain, Barriers to New Competition 207, 212 (1956) ("[A]s to the sorts of entry barriers which may be legitimately attacked, it was observed that those resting on real economies

rejection of the carefully reasoned premises of the Commission's own landmark opinion in *Clorox*,[30] and of the position taken by the Solicitor General only last year in his Brief to this Court in *Clorox*:

> "We would agree with the court of appeals that, in general, advantages afforded by a merger which reflect simply greater efficiency ought not be a basis for holding the merger illegal; efficiency is, after all, a prime goal of antitrust." *Brief for the Federal Trade Commission* at 47, *FTC* v. *Procter & Gamble Co.*, 386 U.S. 568 (1967).

Mr. Turner has succinctly summarized the "overpowering" reasons for rejecting the rule adopted below:

> "First, there is the enormous social interest in progress and efficiency, which has represented one of the primary bases for the policy of promoting competition as it has in fact evolved. Second, to forbid mergers that would or might produce substantial efficiencies would narrow substantially the category of acceptable mergers, thereby drastically

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of large scale plant and firm (whatever their importance) should not and probably could not be removed, because of the adverse effects on efficiency of such removal." (p. 207.) "That economies of scale in production and distribution do not loom large as the basis of barriers to entry is fortunate for the policy-maker, because there is relatively little that can or should be done about them." (p. 212.))

[30] *See FTC* v. *Procter & Gamble Co.*, 63 F.T.C. —, —, [1963-65 Transfer Binder] TRADE REG. REP. ¶ 16,673 at 21,580, 21,585-86 (FTC 1963). Economies of production or physical distribution were not involved in *Clorox*. *Id.* at 21,585. *See also* Elman, *Clorox and Conglomerate Mergers*, 36 ANTITRUST L.J. 23, 25 (1968) ("The Commission emphasized the character of the particular cost advantages, vis-a-vis potential entrants, that the merger conferred on Clorox, finding them not to be the kind of "efficiencies" that antitrust policy is intended to encourage.")

weakening the market for capital assets and seriously depreciating the price that entrepreneurs could get for their businesses when they wish to liquidate. Such a policy would seriously interfere with maximum exploitation of productive resources; and not only might it have adverse long-run effects on entry and growth of small business, but it would also be clearly against the interests of small businesses already in being. It can be at least doubted that if Congress had focused on the issue, it would have wished such a result. Third, the protection that this policy would afford to small business, except in the short run, is at best highly conjectural and probably negligible. There is no doubt that in most instances, certainly when efficiencies from integration are substantial, the same adverse consequences to small business will sooner or later be visited through internal expansion by large firms. The last two points are interrelated: it would hardly be a favor to small businesses threatened with extinction by expanding large rivals, to deprive them of the opportunity to sell to large outside firms at the better prices the large firms would be willing to pay because of the prospects of achieving efficiencies of integration." *Conglomerate Mergers and Section 7 of the Clayton Act,* 78 HARV. L. REV. 1313, 1326 (1965).

The rule adopted below—that the achievement of operating efficiencies is, *per se,* a ground for invalidating a conglomerate merger[31]—should not be al-

[31] Petitioner does not here contend that the fact that a merger results in efficiencies for the acquired firm may be asserted as a defense for an otherwise anticompetitive merger. Petitioner's argument is that it was improper for the tribunals below to assert the fact of such efficiencies as an affirmative basis for holding the merger illegal. In addition, if this Petition is granted petitioner intends to argue the subsidiary question of the appropriateness of divestiture as a remedy, as opposed to an injunctive restriction on cost-saving practices.

lowed to stand without review on the merits by this Court.[32]

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[32] In addition to their novel reliance upon distributional economies, the Commission majority and the Third Circuit assumed that this Court's treatment of the advertising cost savings in *Clorox* applied to the advertising savings found here. The Government in *Clorox* took the position that the generally accepted principles with respect to the antitrust treatment of cost savings did not apply to heavy brand advertising of physically and chemically identical products for which there were no substitutes. The only result of such cost savings, it was argued, would be more advertising which could have no informative function, and this advantage could thus be deemed anticompetitive. This Court agreed. But *Clorox* does not establish a general rule "that brand advertising is inherently or necessarily wasteful," even "where competitive brands are physically identical." *See* Elman, *Clorox and Conglomerate Mergers*, 36 ANTITRUST L.J. 23, 26 (1968). And in this case steel wool products are different from one another—to the point of separate patentability—and different from their non-steel substitutes. The carefully articulated premises of the *Clorox* opinion do not obtain here, and the Commission's reliance upon advertising and promotional cost savings in this case raises new and important questions. *See* BOCK, MERGERS AND MARKETS 150-51 (6th ed. 1968). Commentators have noted sound policy reasons against such an undiscriminating condemnation of advertising cost savings. *See, e.g.*, Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1336-37 (1965).

In lieu of attempting to supply reasons for their reliance upon advertising cost savings in the circumstances of this case, the Commission majority and the Third Circuit sought to draw a parallel between *physically and chemically identical* liquid bleaches and qualitatively different steel wool scouring devices by characterizing the latter as being *"functionally identical."* On this basis they viewed this Court's treatment of advertising in *Clorox* as automatically applicable. This reasoning process, however, would radically expand the *Clorox* holding to all product markets, because all products in competition with one another can be characterized as "functionally identical." Plainly this Court did not hold in *Clorox* that all advertising is socially valueless.

CONCLUSION

It is respectfully suggested that every one of the conglomerate merger rules in question here, even considered individually, deserves this Court's consideration. Taken together, their scope and importance present an imperative case for review. As matters now stand, the opinion of the Third Circuit is the only source of specific guidance, and this case is the only foreseeable opportunity for this Court to prevent the economic harm which, we submit, must follow if the Third Circuit's rules are generally followed, or the years of costly and disruptive litigation which will occur if they must be challenged in other cases.

For the reasons set forth, this Petition for Certiorari should be granted.

Respectfully submitted,

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APPENDIX